TESTIMONY OF
DONALD T. GRAY
BEFORE THE
SENATE COMMITTEE ON INDIAN AFFAIRS
REGARDING
INDIAN TRUST FUND MANAGEMENT

FEBRUARY 26, 2002

My name is Donald Gray. I have testified as an expert previously before this Committee, and I appreciate the opportunity to do so again. I have also recently testified before the House Resources Committee on the same topic. I bring what I hope is a helpful and fresh independent perspective to the Indian Trust reform effort at a time when I believe real change is possible.

I am a partner in the law firm of Nixon Peabody LLP. For 26 years I have specialized in working with institutional trustees and other financial institutions in establishing, administering, reconciling and rehabilitating long-term complex trusts and other money flow arrangements involving billions of dollars of managed assets. Simply put, my business is largely devoted to "fixing" broken trusts in the private sector. The clients of Nixon Peabody's Trust and Financial Rehabilitation Group, which I helped found, include some of the largest money-center banks in the world. I am also an international logistics and shipping expert, and in this area am well-known to the Alaska and Hawaii Congressional delegations as well as all government agencies with jurisdiction in the area.

When I testified previously in July of 1999, the atmosphere for potential change was very different, and not nearly as positive as I believe it is today. Yet, because there has been so little progress in the intervening time on trust reform, much of my prior testimony, especially concerning the precise methods and architecture for true trust rehabilitation in the IIM accounts, remains relevant. Therefore I re-submit that testimony, with minor updating revisions, as Exhibit A hereto.

In short, after following this process for many years and reading all relevant DOI, GAO, outside expert reports and court transcripts, and while I do not claim any panacea for one of this nation's most vexing problems, I believe for the first time there is a light in the forest. There is hope for a truly viable IIM trust fix.

I summarize the reasons for that belief, and the organizational methodology I believe to be essential to the trust fix below:

1. The Need for an Independent Body. What has been missing since the passage of the American Indian Trust Fund Management Reform Act of 1994 is the essential trust fix expertise within the DOI, with the exception of Mr. Homan, whose efforts were consistently thwarted by DOI officials. The other irreconcilable obstacles to trust reform have been the flagrant conflicts-of-interest within the BIA in attempting to fix a broken system it has helped to perpetuate. My conclusion, and the only conclusion I believe a private sector expert can come

to, is that the fix must be under the auspicious of a body independent of the DOI and the BIA. The issues of lack of expertise, crippling conflicts-of-interest and the need for an independent body for the required trust fix are discussed in detail in Exhibit A. My suggestions for the form such an independent body should take – a time-limited, government-sponsored entity ("GSE") – and its Congressional mandate, are set forth below.

2. The Continuing Role of the DOI and the BIA. Before continuing to outline an alternative structure, I want to be clear about the positive role the DOI and the BIA can play in this process. With the exception of the highest-ranking DOI officials of the previous Administration, I do not believe any DOI or BIA employee has deliberately bogged down the process, obfuscated with respect to critical records, or intentionally wasted vast sums on computer systems that were ill-conceived and did not work. There is still a very important job for these BIA officials and employees to do.

The key here is to separate the trust "fix" problem from the day-to-day administration of trust funds. The BIA still needs to perform the basic collection and trust allocation and payment functions as best they can, while trust fixes are developed by the independent body and made a part of the existing trust function over time. However, the BIA employees can no longer be put in the impossible position of attempting to fix a system they and their parents have helped to create and perpetuate, especially since they lack the specific expertise to effect the fix.

In addition to day-to-day administration, such BIA employees would be available to the independent body suggested below, since they possess valuable information about past and present asset management and trust payment procedures. Their input is critical, especially in a case like this where some records have been lost or destroyed. As fixes are developed by the independent body, these employees would be essential in putting them into effect. The law changes required to establish the independent body must permit the full and open participation of these employees in the fix process, as mandated by the independent body, and must protect these employees from internal retribution and/or legal actions for good faith mistakes made in the past.

The interaction of the independent body and its professionals with the BIA trust employees in the fix process also offers a unique training opportunity for the BIA personnel involved. The BIA would learn the new system and proper trust functions from the best experts in the field. Such training can be used by the BIA employees in the years to come within the BIA, in connection with the IIM accounts or other similar trust functions in which the BIA is involved, or in the private sector, as they choose.

3. Inter-Branch Governmental Cooperation. The reason I believe there is hope for a true trust fix now has to do with what I perceive to be the posture of the major participants at this point. Most importantly, both houses of Congress appear willing to take dramatic action on a non-partisan basis. That did not appear to be the case three years ago. Also, despite the characterization of the current DOI officials in the *Cobell* litigation and the press, it does not appear to me that they (unlike Mr. Babbitt and his top aides) are bent on obstruction, nor dead-set against external, independent assistance in reaching a trust fix. Respectfully, Secretary Norton's internal reorganization plan, although well-intentioned, will not work, and pouring another $200 million into that reorganization rather than a fix by real experts is a very great

mistake. This is the only sound conclusion that I can reach after watching the waste of hundreds of millions of dollars over the past eight years on internal reorganization and inept systems, and assessing the lack of proper DOI expertise that Secretary Norton apparently admitted recently in her testimony in the *Cobell* litigation. Again, without the proper expertise, lack of conflicts-of-interest, and independence, an internal reorganization will do nothing. But the DOI's participation in an independent body structure, like the one outlined below, through Mr. McCaleb or another reform-minded DOI official, is essential.

Finally, there is the court. I cannot imagine that anyone would take the position that the heroic efforts of Ms. Cobell, and the tenacity of Judge Lamberth and his assistants, have not been an essential ingredient in shining light on, and narrowing the issues concerning the historic trust defalcations. But, as a purely practical matter, a court-appointed receiver does not appear to be the best answer as to future trust reform. For instance, how will that receiver be paid? How will proper trust fix experts be made available to the receiver? Will that receiver obtain the proper, timely and essential input and cooperation of the BIA officials and employees currently engaged in the trust administration function? As to these matters, I would hope the court and Congress would both seek to find a way to cooperate on the establishment of an independent body charged with that fix.

4. The Independent Body. I believe the best vehicle for effecting a viable trust fix is the creation of a GSE, with a mandate and structure as outlined below. However, except for the independence of this entity, which is essential, there is nothing magic about any part of the following structure. I would invite the Committee, and all interested parties, to suggest structural alternatives if they can be shown to better reach a trust fix in a timely fashion.

a. The GSE would have three levels of participants. This structure would be very lean, and would leverage on outside professionals on an "as-needed" basis.

At the top, all trust fix policies and procedures would be the ultimate responsibility of a "blue ribbon" board of Commissioners drawn from specific public and private sector sources. At least two Commissioners would ideally be acting officials in federal financial institution agencies or bodies, specifically a Governor of the Federal Reserve, a senior official of the Office of Comptroller of the Currency or the Federal Deposit Insurance Corporation. These agencies have a great deal of trust and related financial expertise, as well as regulatory oversight responsibility for the private banking sector. There should also be a representative of the IIM beneficiaries who is viewed in Indian County as financially sophisticated and completely trustworthy. In addition, given the extent of cooperation required between the GSE and the DOI (including the Special Trustee and the BIA), the board should include a high-ranking DOI official acceptable to the other Commissioners and Indian County. The Assistant Secretary for Indian Affairs would, in my judgment, be a likely candidate for this position. Finally, if the mandate of the GSE were broad enough to include Tribal trust issues, a representative approved by the various Tribal organizations should be a Commissioner.

The Commissioners would meet regularly, and should be paid for their time and expenses, but with recognition that they are serving as a very active board of directors, who have primary jobs and responsibility elsewhere. The Commissioners would have the direct and

continuing oversight of the Senate Committee on Indian Affairs and the House Resources Committee.

The next level of the GSE would be an Executive Director ("ED"), with as lean a support staff as possible. This person should have "hands on" trust or other financial fix expertise, such as a former RTC official. The ED would manage professionals, be the liaison between such professionals and the Commissioners on all aspects of reform (*e.g.*, document and records custody and control, identifying and maintaining critical data elements, developing a schematic diagram and design architecture for all aspects of the assets/trust systems, developing and implementing a systems design), be responsible for liaison with BIA trust administrators, and be a "plain language" interpreter for the oversight committees on what will be at times complex procedures employed by the professionals.

The last element would be trust professionals who work constantly in detailed trust accounting and reconciliation, cash flows, investments, control procedures, computer system analysts and implementators. This would include legal trust fix experts, trust administrators, forensic accountants and computer specialists, all of whom have worked on trust reformation and fixes in the past. It would be impossible, and economically prohibitive, to have all such specialists on staff. They may, for periods, be used intensively, but only on an "as-needed" basis. Ideally, there would be a lead professional who would help the ED choose and coordinate the efforts of all other professionals to avoid overlap and promote efficiency.

b. The mandate of the GSE would be to design and implement a viable trust accounting and reporting system inclusive of the entire cycle, from resource leasing to IMM account-holder payments. The GSE would have authority to implement new systems and procedures, if possible on a progressive, partial basis. The GSE would have authority over BIA trust administrators for implementing the fixes and training BIA employees and officials as to proper implementation and maintenance.

c. The GSE would be time-limited. It is suggested that a initial life of five years would be adequate, with authority in Congress to extend this sunset provision, if necessary.

d. Ideally, the GSE would be able to coordinate its efforts with any trust professionals used by the *Cobell* court, or by the parties litigant therein, in accomplishing an accounting or reaching a settlement on past trust practices. As explained in Exhibit A, reconciliations, modeling and findings regarding past practice and mistakes are usually part and parcel of any future trust fix because the latter gleans so much information on proper (and improper) trust accounting from the former. Also, having worked with the plaintiffs' accounting professional on other significant large, historic trust and similar financial fixes, their input, if possible, into designing a suitable program for the future is almost indispensable.

In conclusion, it is ironic and telling that just such an GSE was recommended by Special Trustee Homan in his report (contested by then DOI officials) after several years of frustration in attempting to accomplish an IIM trust fix within the DOI.

EXHIBIT A

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My name is Donald Gray. I am a partner with the law firm of Nixon Peabody LLP in San Francisco. For 26 years, I have specialized in matters concerning commercial trust and institutional fiduciaries. I appreciate the opportunity to testify before you, and to bring what I hope is a helpful and fresh perspective to the Indian Trust Fund reform effort.

For many years, my practice – and the practice of Nixon Peabody's Trust and Financial Rehabilitation Group (the "Group") – centers on trust fixes for major money-center financial institutions. Although the Group's experience is predominately in the commercial sphere, we have also been involved in trusts that touch both the public and private sectors. For example, in the mid-1980's, I authored the series of master and subsidiary trust agreements implementing the settlement between the United States Department of Commerce and the Native American corporations representing the Pribilof Islands of Alaska. Those trusts helped form the basis of the Islands' new economy, as it emerged from more than a century of U.S. Government oversight.

I was pleased to accept Chairman Inouye's invitation to testify on Indian trust funds management by the Department of the Interior (DOI). I believe I bring a perspective which, except for the significant efforts of Mr. Homan during his tenure as Special Trustee, seems to be completely lacking in the current process. That is, the perspective of an independent person or group with significant private sector trust and financial institutions expertise. The key concepts here, and throughout my comments are "independence" and "expertise."

INTRODUCTION

The problems facing Indian Trust Fund reform are admittedly multi-faceted. Understandably, there are micro-economic, institutional, political, cultural and emotional concerns involving the DOI and the American Indian people, which have and will continue to manifest themselves throughout the process. I am not an expert on Indian affairs, nor on the intricate workings of the governmental agencies with responsibilities in these areas. I am a trust lawyer. But after significant research, I have reached the inescapable conclusion that the Indian Trust Fund reform effort cries out for the kind of detached, independent expertise that exists among professional trust administrators, accountants, lawyers and other professionals in the private sector. These are persons who have spent most of their careers dealing with trust problems comparable to those addressed in the GAO Report No. B-280950.

I reach this conclusion because the Indian Trust Fund problems are, first and foremost, financial trust problems based on issues frequently encountered by private sector trust institutions, such as inadequate policies and procedures and poorly planned systems conversions resulting in ineffective recordkeeping. It appears to me that, if the Indian Trust Fund problems are to be effectively dealt with, the resolution process needs to be removed from the vestiges of 150 years of U.S. Government/American Indian relations, with solutions fashioned primarily through the prism of historic structures and viewpoints. In my view, effective reforms will never be accomplished until the fiduciary and financial reporting aspects of Indian Trust Fund management is separated from the DOI's other role in overseeing the social and economic development and political concerns inherent in the U.S. Government/American Indian relationship. These latter concerns, which are an important aspect of the DOI's mission, and the persons responsible for such matters, must, in my opinion, be separated completely from the management of the Indian Trust Funds with the latter function placed in the hands of persons with commercial and financial trust expertise who can identify and implement the systems and resources essential to real trust reform. I am convinced that without such independence and expertise, the affected American Indian people will be deprived of the same high level of money and asset-management services, as well as legal protections, that are available to every citizen of the United States, who puts his or her financial affairs in the hands of another.

THE GAO REPORT

The GAO extensively studied one aspect of the DOI's High Level Implementation Plan (HLP) – the planning and acquisition of a new trust asset and accounting management system (TAAMS). The GAO concluded that the DOI had not developed an overall information systems architecture for the entire business cycle of the trust funds functions – including land ownership and appraisal, utilization and income management, trust fund accounting, investment, custody and records control, and disbursements. Without this architecture, there can be no assurances that isolated systems purportedly providing one function will interact and interconnect properly with systems developed for all other important trust functions. The GAO also found that the DOI, by purchasing the TAAMS off-the-shelf software, had not done enough to assure that all aspects of asset management data (involving complex oil and gas, timber, crop, fishing and other asset pricing, leasing and money flow information) would be accommodated.

The DOI acquired TAAMS, at a reported cost of $60 million, without regard to the GAO's warnings of the need for overall information systems architecture in correspondence with the DOI in 1997 concerning the Special Trustee's Strategic Plan issued in compliance with the American Indian Trust Fund Management Trust Reform Act of 1994 (the "1994 Act"), and in its general guidelines on systems architecture development issued in 1992. The DOI also seemed to ignore the highly integrated approach for trust fund clean-up, rehabilitation and implementation recommended by the Special Trustee in his April 1997 Strategic Plan issued in compliance with the 1994 Act. Similarly, the DOI appears to have overlooked the specific directives of that statute (the governing document for all trust reform) to accomplish all aspects of reform in an integrated, coordinated and properly interactive process. The DOI also seems not to have heeded the advice of Macro International Inc., consultants to the Office of Special Trustee (OST), which found in 1997, after significant research into the personnel and training deficiencies of the DOI's

reform effort, that any implementation of a technologies infrastructure to solve the manifold trust problems first required the foundation of well thought-out practices and procedures relating to overall integrated reforms that would assure a comprehensive output consistent with commercial standards. In other words, without accurate data collection and input, no software system, even the most sophisticated, can achieve the required objective of providing accurate financial reporting.

As an outside trust expert, I must question why the DOI staff would apparently ignore the GAO, a highly qualified finance expert, former Special Trustee Homan, outside consultants, and finally, the governing statute, by purchasing an off-the-shelf system, at enormous expense, without any clear assurance that it will be integratable with other key aspects of trust reform, or even that it will be able to process all data variables inherent in the vast array of Indian Trust Fund assets. One theory is that that such an extraordinary action is a symptom of a larger problem. The symptom, which I have seen in the commercial context, is the almost frantic attempt, when existing procedures fail, to grasp for a quick fix, even if the fix merely creates the appearance of a solution.

As explained below, any asset management system must be extremely agile and have the ability for constant modification to accommodate all the data variables inherent in the IIM assets. I believe it has been convincingly demonstrated that the TAAMS system is a failure in this regard and there are serious questions as to the compatibility of the system with other systems, or its consistency with an overall architecture, which does not yet exist.

The larger, and much more fundamental problem, is that the DOI and its internal Bureaus are encumbered by serious conflicts-of-interest, although not of their own making. It is highly probable that such extreme conflicts-of-interest will inevitably drive the DOI, its captive OST, and the Bureau of Indian Affairs (BIA) to actions that are not directed solely at rehabilitating and correcting accounting for all trust assets properly creditable to the Individual Indian Monies (IIM) accounts, the only true goal of the 1994 Act. The very essence of trustee status and integrity, and of fiduciary responsibility, is the absence of conflict-of-interest.

WHAT IS SYSTEMS ARCHITECTURE?

If I may be permitted a small digression, I suspect that some of the Committee members may be a bit confused with the overly technical jargon used by the DOI, the GAO and, admittedly, trust professionals like me. It may be helpful to decipher what "systems architecture" means, at least to me.

When professional trust experts approach the original set-up or historic reconciliation of a complex income asset/money flow/investment trust, they first start with a comprehensive listing of all possible data input, incorporated into a conceptual diagram of how that data must flow through each and every phase of the trust accounting system (appraisal, leasing, accounts receivable, accounts payable, any special cash flow allocations like reserves, posting to proper accounts, investment accounting, account ownership records and disbursements). In addition, assessments are made of the personnel expertise needed to keep track of, analyze and control all such information. Finally, there is a narrative conceptualization of how information/technology

(*i.e.*, computer) systems can facilitate the above processes as well as an identification of so-called "inflection points," where one technical system's data is downloaded to people for analysis and re-uploaded to other systems, or where two technical systems can and should interface to transmit critical data. This process must be substantially complete before any one automated system is specified or purchased.

Put another way, seasoned trust professionals in the commercial context first apply simple common sense to the problem. This sounds obvious and easy, but it is far from it. In a trust rehabilitation context, this foundational process involves what we call in the industry "scrubbing." That is, the architects of a workable system must roll up their sleeves, review thousands of potential data input variations (past and future), conceptually design how trust data flows through a multi-phase system, perform calculations on trust data and explain what people should do, and what computer hardware and software should do, to implement the system.

This is some of the hardest work in professional trust management and requires expertise in all facets of commercial trust accounting and, typically, legal interpretation of trust instruments and governing laws. First and foremost, administrators must resist the sometimes inexorable urge to look at computer systems as panaceas for any complex problem. Computer systems do not think. Hopefully, they are designed by people who do think, and who are intimately familiar with processes and calculations which are being automated. They gain this knowledge by working intimately with such a multi-disciplinary trust team for countless hours. After flowcharting the desired processes or calculations, they write or procure a software program (or package of programs) embodying them. If the software is designed and programmed well, a computer system can then perform such processes and calculations in bulk and at great speed.

Also, computer systems do not self-correct and expand themselves to create new capabilities for handling information/data with which they were not designed to cope. I have seen highly sophisticated trust and asset management commercial systems that do a splendid job with 90% of complex data or analysis, but utterly fail to accommodate, or be modified to accommodate, 10% of the required data or analysis. Unfortunately, 90% correctness for millions or billions of dollars of managed assets does not sit well with investors and other beneficiaries.

Although seemingly reasonable to the lay person, the former DOI Secretary's comments concerning the selection of a 'near enough' off-the-shelf asset management system, by selecting a system developed not for the IIM trust reform, but for an "analog" problem, is a bit frightening to a trust professional.

As the GAO report indicates, instead of the "intricate and complex coordination process" of all facets of the reform effort called for by the former Special Trustee in his Strategic Plan, the DOI's HLP leaves the IIM effort with a disjointed, potentially non-integratable mishmash of project initiatives, and the occasional "big splash" computer system for one element of the task that may work only for highly selective data. But the current trust reform effort, as evidenced by the DOI's HLP, contains features far more troublesome than a potential functionally deficient, or non-integratable TAAMS product.

INDEPENDENCE, EXPERTISE AND AN INTEGRATED APPROACH

Although both the HLP and the Special Trustee's Strategic Plan admittedly contain similar, and undeniably necessary, tasks essential to account clean-up, reform and new systems building (including data clean-up, records retention and proper custody, workable trust accounting and asset management procedures, investment, accounts and land title, appraisal and probate clean-up), these are no more than static descriptions of jobs to be performed on a coordinated basis. What is of ultimate importance is the philosophy, mission goal and the resulting and overriding "how" to attack all these deficient areas. Respectfully, while the former Secretary plucked out independent projects that are undeniably important to trust reform, he specifically and dramatically gutted the Special Trustee's Strategic Plan of its two essential cornerstones for such an overriding mission and goal – independence and expertise. Without these elements, which create both a reform environment and give it its essential tools, meaningful trust reform will not occur.

The Special Trustee's Strategic Plan, in its first two pages, could not have been clearer on this all-important "how." First, with some courage, Mr. Homan called for a completely independent and neutral body, a Government Sponsored Enterprise ("GSE"), to take over the trust rehabilitation process, under the supervision of government agencies expert in commercial finance and modern trust procedures. He continually cites the ongoing conflict within the DOI in failing to separate its special trust reform fiduciary goals from its general responsibilities in education, housing, law enforcement and a multitude of other welfare programs and other American Indian services provided by the DOI and its Bureaus. In short, Mr. Homan concluded that, in the competition for the limited funds appropriated to the DOI, when a choice must be made between a department's general responsibilities and trust fund reform, the latter program would inevitably suffer.

What is also obvious from the HLP's allocation of responsibility for its 13-category, piecemeal approach to reform, is that there is at least an unconscious attempt to employ the other internal Bureaus of the DOI, especially the BIA, in these processes, regardless of a proven lack of expertise, since only two of the projects are reserved to the OST. This foreshadows two very negative results. First, it displays a lack of appreciation for the expertise, and long-term training required for trust rehabilitation and administration, and suggests that involving these internal DOI Bureaus is of greater importance than solving the trust fund problems. The DOI's loyalty to one of its Bureaus, the BIA, is laudable, but completely inappropriate in the IIM trust reform process. Second, the misguided piecemeal methodology of the HLP permits agency employees, no matter how much they may wish to act in good faith, to attempt to solve the trust fund problems by purchasing an expensive new software system, creating the impression that by do doing they are attempting to obscure past mistakes with an easy, but ineffective fix. This is not intended to be an indictment of such personnel, it is simply a recognition that human beings, no matter how fair-minded and well-intentioned, should never be asked single-handedly, in isolation and without expert advice to rehabilitate a process which has gone seriously awry during their historic involvement in the process.

For a commercial trust practitioner, deeply involved in the activities of bank trust departments, and a veteran of dealing with the Office of the Comptroller of the Currency (OCC), and other federal agencies, state banking authorities, accountants and rating agencies in

connection with audits of trust and fiscal agency procedures, the equally apparent inability of the DOI staff to appreciate the level of expertise required for the rehabilitation and modernization of a trust problem as vast as the IIM accounts issues is surprising to me. I cannot put this any more clearly than former Special Trustee Homan did in his Strategic Plan, and I fully concur with his conclusions. Regarding the lack of trust managerial resources within the DOI, and the BIA specifically, Mr. Homan states:

> Managers and staff of the BIA have virtually *no effective knowledge or practical experience* with the type of *trust management* policies, procedures, systems and *best practices* which are so effective, efficient and *prevalent in private sector trust departments and companies*. The BIA area and field office managers do not have the background, the training, the experience, the financial and trust qualifications and skills, necessary to manage the Federal Government's trust management activities according to the exacting fiduciary standards required in today's modern trust environment. Thus, and through no fault of their own, and *even assuming financial resources were made available, they are not capable of managing effectively the Federal Government's trust management activities on a par with* that provided by *private sector institutions* to their customers. . . " [emphasis added]

If your or my bank or trust company were to handle our assets with completely unqualified personnel, in a manner that can be described metaphorically as a "shoe box" approach to accounting, we would be in court, or at the steps of the OCC or other appropriate regulator the next morning. That was one of the great lessons of the financial institution crises of the 1980's.

The independent contractors, Macro International Inc., Larson Slade Associates, LLC and Arrowhead Technologies, in cooperation with project resource firms (such as Riggs Bank, NationsBank and State Street Bank and Trust) echoed Mr. Homan's conclusions after hundreds of DOI personnel interviews. Their goal was, in part, to identify any gaps between the current Indian trust systems and trust departments in the commercial sector. These consultants concluded in 1997 that the accepted legal and procedural standards of fiduciary responsibility to manage trust assets and accurately report on their status to beneficiaries were not being met. Without properly trained personnel, and without a "single-point management responsibility" like a GSE, the current system falls far short of commercial trust standards. What is needed, these consultants found, is a single trust organization, with complete control over both resource and financial assets utilizing tried and true commercial applications. Finally, they concluded that all of these tasks will fail to improve the Indian Trust Fund reform process unless an effective and efficient staff is able to carry out the tasks.

A quick look at previous DOI budgets demonstrates with clarity the Agency's historic opinion of these expert findings. Although these numbers have since been inflated, the previous Administration's HLP, for combined fiscal years 1999 and 2000, called for a budget for computer software "systems" of $51.1 million. For the same years, this budget for "training" is a meager $7 million, and even that relates solely to on-the-job training for BIA officials (which the

consultants found generally ineffective) rather than for the hiring of experienced commercial trust administrative staff. So much for expertise.

With the growing complexity of investment vehicles, asset-backed securitizations and their correspondingly complex cash flows (not unlike the IIM accounts), modern trust administration requires a level of financial and technical expertise that was unheard of twenty years ago. What once required a few accounting courses and on-the-job bond payment training, now frequently requires advanced degrees in money management, fiduciary standards and laws, complex cash flow analysis techniques (called "analytics" or "modeling"), dexterity on PC-based spreadsheet and database systems, a complete understanding of permitted investments, overnight "float" investments, special cash accounting systems and the use of complex computer programs. Even with this training, and with the constant support of expert supervisors, tax specialists, accountants and attorneys, it takes years to develop the intuitive expertise to perform proper trust accounting. To my knowledge, not one person from the commercial sector with such a background is presently on the staff of the DOI.

Again, I must ask why the DOI has completely ignored the critical need for such independence (*i.e.*, lack of conflicts-of-interest) and expertise. One might guess that this answer would be the very "special" nature of U.S. Government/American Indian relations, and the ultra-sensitivity the BIA and the other DOI Bureaus bring to this special problem. But from the outside this rather looks more than suspiciously like institutional self-perpetuation, obfuscation of past mistakes, and at worst, the kind of paternalism that should have gone with the wind many years ago.

A PROFESSIONAL TRUST APPROACH

How would a team of commercial trust experts approach a problem like IIM reform, and how does the DOI's course of action compare to such a commercial approach?

Although admittedly a long time in the making, commercial trust entities have tackled efforts just as daunting as the IIM problem, especially when they have inherited active asset trusts which have been mismanaged.

An overview of a typical step-by-step approach to a major "fiduciary fix" of a private sector trust organization follows:

Step 1. <u>Assemble a Team</u>.

The first step is to assemble a team consisting of highly experienced trust professionals, accountants who specialize in detail analysis of trust accounts, cash flows, investments and control procedures, legal experts knowledgeable about the governing law, documents and the practical general industry practices, and computer systems analysts, specifically trained to translate conceptual architecture developed by the other team members into software systems requirements. We are not talking about hundreds or even dozens of people. Although they may all require expert staff assistance, at the core, we are talking about four to six trained

professionals. I and my colleagues in the industry have worked successfully with many such teams.

Step 2. Assure the Project Team's Independence.

The next step is to establish the absolute independence of the project team. As I have mentioned to many interested people on the Hill during the past three years, establishing independence for the team responsible for either fixing a broken trust, or creating an entirely new trust system for a complex array of assets, money flows and beneficiary variables, is essential. That team would initially meet with personnel historically involved in the trust, or trust asset process. Those people will be separated and protected in the trust fix process. By this I mean that there will be the immediate recognition that those involved in a historic process where mistakes have been made, whether or not they personally have made them, are exactly the wrong people, at least at the initial phases, to be actively engaged in rehabilitation or designing replacement systems. The natural urge of all of us is to mitigate, gloss over and in extreme cases, hide past mistakes, and that urge can frequently take precedence over sound reform efforts. And yet these people, in this case DOI personnel, must be protected. Their institutional historic knowledge of problems, where data is to be found, what external pressures have been brought to bear at the expense of proper functioning, and a multitude of other essential information, resides in the memories of these people. If they are told that they will not be fired or otherwise punished for human errors and mistakes (short of criminal self-dealing, which I doubt is a serious concern here), they can be of tremendous help. But if they are left alone to fashion all reforms, they are being required to do the impossible – protect themselves and their families while being asked to single-mindedly protect the interest of IIM beneficiaries. Again, all efforts, at all levels, must be employed to eliminate such fatal conflicts-of-interest.

Step 3. Establish Document Custody and Control.

The next step of the team is to establish the strictest document custody and security measures possible. Every piece of historic data that is contaminated or disappears diminishes the integrity of any reconstruction effort, and eliminates data variables, and potential problems that may likely recur, and therefore should be collected, solved and input into a system that can accommodate all data variables and similar problems in the future. Past reports by the Department of Justice and the Special Master in the class action litigation regarding BIA document destruction and general substandard condition of trust record maintenance make this step an obvious priority.

Step 4. Identify Data Elements.

Next, the data elements relevant to all phases of the trust business cycle must be identified, whether relating to land records/ownership, asset management or trust accounting functions of proper crediting, investment and disbursement. Further, an analysis of how that data has, and may change over time is critical. Systems, especially automated systems, do not usually adapt well to data changes. Significant experience, knowledge and creativity in the ever-changing nature of land resource exploitation, investment parameters and ownership variables are required at this stage.

Step 5.Develop a Schematic Diagram.

Then comes the hardest part, the development of a narrative, logical but highly complex non-automated schematic diagram (which could cover the walls of this hearing room), demonstrating how all collected data must move, interface, inter-relate and be re-analyzed, recalculated and otherwise re-assessed to assure that all functions of a highly integrated lease-to-beneficiary disbursement system will, at least conceptually, work. For lack of a better term, this is the conceptual model, or overall architecture of any complex trust problem. In the end, if an experienced commercial trust administrator, with the aid of only an HP or a simple PC-based spreadsheet system, cannot track financial data from lease billing to beneficiary disbursement, throughout all the intervening trust business functions, then all the elaborate personnel task forces and isolated pieces of systems software, no matter how sophisticated, will be worthless. All the functional elements of the business cycle must be analyzed simultaneously and interactively at this conceptual architecture phase, or hundreds of millions of dollars in "magical fix" systems will be purchased, and ultimately wasted.

Step 6.Design Architecture.

Next, experienced trust systems analysts, capable of fully comprehending the conceptual architecture, and fully knowledgeable about the universe of commercial off-the-shelf (COTS) trust accounting systems and custom applications providers, can begin to design an interactive systems architecture to accommodate all functions. This does not mean such an expert independently develops separate, or fully integrated software components. What is does emphatically mean is that one person, or a group of extraordinary trained people, is fully cognizant of both the overall goals and the intricate conceptual plan based on actual data and the universe of automated solutions that might be brought to bear to facilitate the conceptual design. Then, and only then, are requirements developed, and systems pre-tested and finally purchased, and then only with extensive warranties, retrofitting and modification undertakings and extensive service, support and back-up packages.

Step 7.Recruit Permanent Trust Administration Staff.

Automated systems are only as good as data input performed by skilled trust administrators. Further, if multiple automated systems are used, such administrators must constantly monitor whether the systems are correctly interfacing and exchanging information, since this is an area of frequent difficulty given the ever-expanding universe of data variables and money calculations which flow through those systems. This requires knowledge of the basic functions these systems perform. Data variables, and sometimes simple automated systems breakdowns (or "crashes"), or failures due to viruses, require trust administrators to constantly test the validity of systems calculations, usually by "shadow" calculations mimicking the essential tasks of any automated systems, performed on single stand-alone spreadsheet PC systems. This is painstaking work, and requires significant experience.

I have read the Special Trustee's Strategic Plan, the HLP, the GAO report referred to above and countless preceding GAO reports, hundreds of pages of court transcripts and Congressional testimony, outside consultants reports, and press releases and studies of the DOI and its internal Bureaus. And yet, I am far from an expert on all IIM reforms to date. However,

I respectfully ask the DOI, the former Special Trustee, the Advisory Board established by the 1994 Act, the members of this Committee – what kind of a report card would you give to the DOI during the past few years based upon the above model of a well- thought-out, rehabilitation approach?

The following hypothetical, admittedly from a different but similar context, may help to put the current state of affairs in perspective. After growing up through the New York City public school system in the 1950's and 1960's, this hypothetical has meaning to me, and hopefully to others present.

Suppose a blue-ribbon group of local merchants, professionals and workers in an inner-city environment decided to establish a multi-faceted urban redevelopment project, aimed at dramatically improving the lives of the low income majority living in the area. The group engages the help of health professionals to set up clinics, educational professionals to establish remedial programs and vocational education to augment a perpetually underfunded public school system, artists and musicians to establish creative centers as counters to drugs and crime and off-duty police to assure an atmosphere of security rather than fear. Assume the group also sets out to develop an investment and asset management program to help the populace invest their hard-earned savings, budget their household funds to maximize the best life style, and to manage income-producing property that belongs to individuals or civic associations. Suppose this group over time, through successes, attracted local, state, federal and private non-profit funding to facilitate its programs.

Now, assume five solid years of demonstrable success. The streets are safer, drug use among the young is down, educational achievement and job retention is higher, and health benefits have reached homes never reached before. But also assume that the organizing group, simply due to lack of time and resources, neglected the asset management and investment functions with respect to potentially millions of dollars of poor people's money. Records were literally kept in shoe boxes, or lost, pending the engagement of financial professionals, or deposits in regulated financial institutions, that the group always intended to do, or to make, but simply failed to do given the enormity of the task it had undertaken. The result is millions of dollars of unrecoverable losses for citizens, and no adequate program in-place to manage the assets or invest the money, assuming the group even knows or can locate current balances.

As a citizen, or a state regulator, what would you do? Would you, out of anger and frustration, seek to punish the individuals who had formed the redevelopment project, or end the project itself? I doubt it. But would any sane person, in their wildest dreams, allow the control persons, who are now heavily conflicted and who lack any financial expertise, to continue to manage the assets and money out of the shoe boxes, and to spend fabulous amounts of other people's money to buy computer systems, with grand but empty promises to solve all problems? I do not believe so. Any responsible person would take what money they could find and deposit it in a bank, and transfer what assets they could find to a bank trust department. Then, under proper regulatory guidance, true experts would be employed to reconstruct proper balances, probably on a modeled test case basis given the paucity of records, and true reform would begin.

Why should the American Indian beneficiaries of the IIM accounts be treated with any less reasonableness and fairness?

CONCLUSIONS AND RECOMMENDATIONS

The leaders of the DOI and the BIA, and the rank and file of those entities in Washington and in the field, no matter how well-intentioned, are seriously conflicted in the process of Indian Trust Fund Reform. If fiduciary integrity means anything, it means the absence of such conflicts-of-interest posed by concerns of job security, political survival, institutional longevity and self-protection against blame for historic errors. People of good faith can argue about the meaning of the prudent investor rule, or other high fiduciary standards of care. But after a professional lifetime of attempting to reconcile textbook standards of care for trustees with real work capabilities of human beings like you and me, I (along with many courts, bank regulators and the Federal Securities Acts) have concluded that professional fiduciaries must, at the very minimum, be trained in state-of-the-art money management, completely free from conflicts-of-interest, and must treat the assets of others in their care as though they were the personal assets of the trustee, his or her spouse, and children. When the former Secretary of the Interior chose to backburner Mr. Homan's concerns about trust standards of care, along with the Special Trustee's concerns about independence and expert staffing, in the HLP, it became clear that the only governing standard would simply be the best the DOI/BIA could do, hampered as they are by a void of necessary expertise and in the face of serious conflicts. This is not a fiduciary standard. This is capitulation to the *status quo*, with a correct accounting for the IIM accounts at best only a secondary or tertiary concern.

I strongly believe that the only viable answer to the present trust reform problems is the creation of a neutral body, independent of the DOI, with both public and private support and input. The GSE suggested by the former Special Trustee Homan in his Strategic Plan is one such vehicle. The Indian Trust Management Reform Authority recommended by the Chairman of the Intertribal Monitoring Association on Indian Trust Funds could also serve such a purpose.

Ideally, such an independent body would be sponsored by, or have some connection with a banking or other financially sophisticated federal regulatory or quasi-governmental body. Obvious candidates would include the OCC or, perhaps, one of the federally sponsored entities, such as Ginnie Mae or Freddie Mac (or its related entity, the Federal Housing Finance Board), which are intimately familiar with complex active asset/cash flow trusts. It is also essential, in my mind, that oversight be retained by this Committee as well as the Senate Committees on Indian Affairs and the Energy and National Resources Committee.

The structure of the neutral body need not be complex. In its simplest form, it would be administered by a financially sophisticated person with experience dealing with inter-governmental agency issues. In addition to government financial input, such an entity must have the ability to engage trust experts from the private sector, representing the disciplines referred to above in connection with a proper commercial approach to solving the IIM trust problems. It is my belief that such an entity would be able to obtain the services of highly qualified trust administrators, accountants, lawyers and systems experts who would be willing to work on this problem. Believe it or not, there are many people in the private sector who understand how

important this problem is, and would be willing to devote extraordinary effort to help forge a real solution.

The budget for such an enterprise could be a fraction of the DOI's expected Indian Trust Fund reform requests. Its mission would be to develop the critical conceptual and systems architecture described above, and called for by the GAO, in order to assure that future spending is actually aimed at viable solutions. No input would be ignored. The cognizant Congressional Committees, the GAO and the DOI/BIA would be consulted on an ongoing basis. The entity should be task specific, and should have a sunset timeline coordinated with trust reform progress, although some viable means of continuing trust supervision, or progressive privatization, would be required. Such a small, well-controlled, highly dedicated and expert group, if given the cooperation of the DOI, could not only accelerate implementation of a properly integrated trust function for the entire IIM business cycle, but would also go a long way to relieve the unhealthy pressure that has built up around the historic approach to this problem.

A few years ago, the head of the BIA cited a concern about potential independence for the IIM trust function that is very telling. He voiced a serious concern that wresting this problem from the BIA might spell the end of that Bureau as a viable governmental body. Although his concern has nothing to do with the Trust Reform Act's primary purpose of assuring IIM trust reform for the Indian beneficiaries, one can certainly be sympathetic with a concern that hundreds of people, many of whom are American Indians, may not have viable work in the future. But I would respectfully suggest that the kind of neutral body I and others are recommending might present an opportunity of a lifetime for many American Indians, within and outside the BIA. With the tremendous growth of retirement assets and the use of complex trust structures as investment vehicles, this country needs more qualified trust administrators. Given the increasingly high qualifications required for such professionals in the private sector, many move on quickly to other financial positions, such as investment banking. The staff of any neutral body would constantly be interfacing with many of the BIA staff who are currently working on the problem, and who would continue to do so in cooperation with the neutral body. The opportunities for real, commercial level trust administration training is obvious. Whether an affected BIA staff person chose to use such training in government service, or in working with Indian-owned independent banks or any independent bank or trust company, his or her prospects for the future could be far brighter than continuing to work on any single-purpose project.

The most important observation I can make, as a dispassionate outside professional, is for all major players in this process – including the DOI, the American Indian groups, the U.S. Congress and the Federal courts, to take advantage of the opportunities inherent in the present state of affairs.

This problem has been a long time in the making. The present staff of the DOI did not make the problem, and, in fact, have made some valiant efforts to solve it. But the DOI has already lost control of the process. This is because the historical accounting, reconstruction and rehabilitation of the IIM accounts is currently in the hands of the Federal courts, and will be played out in some kind of court-mandated accounting, a receivership or a consensual settlement process, in each case requiring outside trust professionals to determine how history is to be reasonably reconstructed. I can state with some assurance that in a trust problem of this

magnitude, the validity of the systems designed to take care of future trust and asset accounting will depend in large part on what is learned in that historic accounting and reconstruction process, even if that process is accomplished largely on a sample modeling basis. Simply put, most if not all of the variables involved in complex asset leasing and accounting, in beneficiary succession and in custody problems have already presented themselves in the protracted history of the IIM accounts. Those data variables are the building blocks for any future systems or procedural architecture. The intricacies of leasing potato land in Idaho, as opposed to oil and gas deposits in Oklahoma, and what has gone wrong in the respective accounts payable/accounts receivable histories of such leasing, is vital information for any new asset management system.

What I am suggesting is that the two processes – historic accounting/reconstruction and future systems development are irrevocably linked. The experts of any independent body charged with future asset and trust accounting design, unless they are to duplicate effort, must talk with the experts involved in the reconstruction process. Ideally, at some point those processes should be combined. But the point is that one portion of the "fix" process, historical accounting, is already in the hands of a neutral body, the court. It makes little sense, then, since both aspects of the fix must be irrevocably linked, to leave the largely derivative portion, new systems, to a governmental agency, steeped in the knowledge of Indian welfare, but devoid of any trust expertise and heavily conflicted. This makes even less sense since the entity currently working on the future systems fix, the DOI, is in a legally adversarial posture in the current Federal court proceedings where the historical fix is being played out.

When the recommended independent body is formed, serious consideration should be given to combining any court-mandated accounting or receivership reconstruction effort with new systems development tasks of that neutral body.

Politics and institutional self-preservation aside, it is time for the DOI to let go, to the extent it has not already been forced to do so by the pending class action litigation.

I would also hope that all those involved, given the nature of the interests of the American Indian beneficiaries at stake, would take a strictly non-partisan approach to the trust reform process.

Finally, and briefly, I would like to remark on past published statements reportedly made by DOI officials in defense of their various reform efforts. Purported statements branding constructive critics of the DOI's efforts as "anti-Indian" are very regrettable. So are suggestions that anyone opposing the DOI/BIA reform effort, and the proposed additional funding for that process, are simply motivated by a desire to keep money from the Indians.

As a seasoned business lawyer, I am unfortunately inured to even this kind of name calling. People say unfortunate things when they are on the defensive. If these labels are put on me because of my testimony, so be it.